

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN**

**REPORT ON FINANCIAL STATEMENTS  
(with required supplementary information)**

**YEAR ENDED SEPTEMBER 30, 2006**

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## INDEPENDENT AUDITORS' REPORT

Michigan State Hospital Finance Authority  
Lansing, Michigan

October 17, 2006

We have audited the accompanying basic financial statements of the Michigan State Hospital Finance Authority, a proprietary component unit of the State of Michigan, as of and for the year ended September 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Michigan State Hospital Finance Authority as of September 30, 2006, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 17, 2006 on our consideration of the Michigan State Hospital Finance Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages v and vi is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*Maner, Costinison & Ellis, P.C.*

Certified Public Accountants



JENNIFER M. GRANHOLM  
GOVERNOR

STATE OF MICHIGAN  
DEPARTMENT OF TREASURY  
LANSING

ROBERT J. KLEINE  
STATE TREASURER

**Management's Discussion and Analysis**

We are pleased to present the financial statements of the Michigan State Hospital Finance Authority. The Michigan State Hospital Finance Authority (the "Authority") was organized under Act 38 of the Michigan Public Acts of 1969. The mission of the Authority is to provide low cost capital financing to non-profit providers of health care services that participate in any phase of the continuum of health care. It is the vision of the Authority to be the first choice of capital financing sources for all health care providers in the State of Michigan.

The Authority is a public corporate body within the Michigan Department of Treasury, Bureau of Bond Finance. The Authority is governed by a seven-member board appointed by the Governor with the advice and consent of the Senate. The Authority is a proprietary component unit of the State of Michigan.

The Authority issues or sells tax-exempt bonds in the national public finance markets. The proceeds from these bonds are then lent to providers of health care services to finance capital projects. Short term financing is also available through the Authority's Health Care Equipment Loan Program (HELP). This is a pooled loan program, which provides financing for equipment, small capital projects and renovations.

The following is a condensed summary of financial information for the years ended September 30, 2006 and 2005, respectively.

**Condensed Financial Information**

| Category                | 2006         | 2005         |
|-------------------------|--------------|--------------|
| Total Assets            | \$ 6,056,451 | \$ 5,986,175 |
| Total Liabilities       | 248,936      | 479,712      |
| Total Net Assets        | 5,807,515    | 5,506,463    |
| Operating Revenues      | 999,146      | 960,507      |
| Operating Expenses      | 886,571      | 952,797      |
| Operating Income (Loss) | 112,575      | 7,710        |
| Nonoperating Revenue    | 188,477      | 81,431       |
| Change in Net Assets    | 301,052      | 89,141       |
| Ending Net Assets       | 5,807,515    | 5,506,463    |

Fees charged to its clients fund the operations of the Authority. The fees are based on the outstanding debt of its clients. For fiscal year 2006 the new bond issues exceeded the principal retirement of debt by \$800 million. The operating revenues reflect this additional increase in principal debt outstanding.

The methodology for the allocation of expenses is determined by the Bureau of Bond Finance. This methodology allocates payroll and other indirect expenses on predetermined percentages. The allocation method of calculating the compensated absences liability changed this year to accurately reflect the actual payoff when it occurs. This change in the allocation method caused the Authority salary expenses to decrease for 2006. Because of the change in the allocation method overall the Authority operating expenses for 2006 were lower than the prior year.

Nonoperating revenue increased this year, because of the increase in the amount invested in the portfolio and the weight average interest rates were higher than the prior year. The par amount invested in the portfolio increased this year by \$1.1 million. The weighted average interest rates on the portfolio were 3.45% and 2.85% for 2006 and 2005, respectively.

The Authority issued over \$900 million in debt this past fiscal year with interest rates varying from 2.71% to 6.75%. Five of the clients served this year were new clients for the Authority. The offset to this issuance was that \$373 million of prior Authority bond issues were refunded.

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN  
STATEMENT OF NET ASSETS  
SEPTEMBER 30, 2006**

**ASSETS**

**CURRENT ASSETS:**

|   |                  |
|---|------------------|
| Cash and cash equivalents (Notes 1 and 2) | \$ 462,354       |
| Amounts due from primary government       | 33,728           |
| Amounts due from other governmental units | 4,486            |
| Investments - operations (Notes 1 and 2)  | 2,386,345        |
| Other current assets:                     |                  |
| Investment income receivable              | 39,648           |
| Administrative fees receivable            | 608,629          |
| Due from H.E.L.P. issues (Note 3)         | 240,000          |
| Total other current assets                | <u>888,277</u>   |
| Total current assets                      | <u>3,775,190</u> |

**NONCURRENT ASSETS:**

|   |                            |
|---|----------------------------|
| Restricted assets:                                |                            |
| Investments (amounts due hospitals Notes 1 and 2) | 65,400                     |
| Investment income                                 | 2,909                      |
| Total restricted assets                           | <u>68,309</u>              |
| Unrestricted:                                     |                            |
| Investments - operations (Notes 1 and 2)          | <u>2,208,864</u>           |
| Capital assets (Note 4):                          |                            |
| Property, plant and equipment                     | 64,114                     |
| Less accumulated depreciation                     | <u>(60,026)</u>            |
| Total capital assets                              | <u>4,088</u>               |
| TOTAL ASSETS                                      | <u><u>\$ 6,056,451</u></u> |

**LIABILITIES**

**CURRENT LIABILITIES:**

|  |               |
|--|---------------|
| Accounts payable and other liabilities - due hospitals | \$ 34,009     |
| Deferred revenue                                       | 1,333         |
| Total current liabilities                              | <u>35,342</u> |

**NONCURRENT LIABILITIES:**

|   |                |
|---|----------------|
| Employee compensated absences and sick leave (Note 5) | 179,294        |
| Amounts due hospitals ( Note 1)                       | 34,300         |
| Total noncurrent liabilities                          | <u>213,594</u> |
| Total liabilities                                     | <u>248,936</u> |

**NET ASSETS:**

|                                  |                            |
|----------------------------------|----------------------------|
| Invested in capital assets       | 4,088                      |
| Unrestricted                     | 5,803,427                  |
| Total net assets                 | <u>5,807,515</u>           |
| TOTAL LIABILITIES AND NET ASSETS | <u><u>\$ 6,056,451</u></u> |

See notes to financial statements.

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY**  
**A COMPONENT UNIT OF THE STATE OF MICHIGAN**  
**STATEMENT OF ACTIVITIES**  
**YEAR ENDED SEPTEMBER 30, 2006**

| <u>Functions/programs</u>      | <u>Expenses</u>   | <u>Charges for<br/>services</u> | <u>Net<br/>revenue and<br/>change in net<br/>assets</u> |
|--------------------------------|-------------------|---------------------------------|---|
| Primary government:            |                   |                                 |   |
| Business type activities:      |                   |                                 |   |
| Hospital Finance Authority     | <u>\$ 886,571</u> | <u>\$ 999,146</u>               | \$ 112,575  |
| General revenues:              |                   |                                 |   |
| Unrestricted investment income |                   |                                 | <u>188,477</u>  |
| CHANGE IN NET ASSETS           |                   |                                 | 301,052   |
| NET ASSETS, beginning of year  |                   |                                 | <u>5,506,463</u>  |
| NET ASSETS, end of year        |                   |                                 | <u>\$ 5,807,515</u>                                     |



**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY**  
**A COMPONENT UNIT OF THE STATE OF MICHIGAN**  
**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**YEAR ENDED SEPTEMBER 30, 2006**

**OPERATING REVENUES:**

|                |            |
|----------------|------------|
| Authority fees | \$ 999,146 |
|----------------|------------|

**OPERATING EXPENSES:**

|   |         |
|---|---------|
| Personnel services                            | 483,317 |
| Purchased professional and technical services | 356,473 |
| Purchased property services                   | 18,371  |
| Other purchased services                      | 14,186  |
| Supplies                                      | 7,577   |
| Depreciation                                  | 6,647   |

|                          |         |
|--------------------------|---------|
| Total operating expenses | 886,571 |
|--------------------------|---------|

|                  |         |
|------------------|---------|
| Operating income | 112,575 |
|------------------|---------|

**NONOPERATING REVENUES:**

|                   |         |
|-------------------|---------|
| Investment income | 188,477 |
|-------------------|---------|

|                      |         |
|----------------------|---------|
| CHANGE IN NET ASSETS | 301,052 |
|----------------------|---------|

**NET ASSETS:**

|                   |           |
|-------------------|-----------|
| Beginning of year | 5,506,463 |
|-------------------|-----------|

|             |              |
|-------------|--------------|
| End of year | \$ 5,807,515 |
|-------------|--------------|

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY**  
**A COMPONENT UNIT OF THE STATE OF MICHIGAN**  
**STATEMENT OF CASH FLOWS**  
**YEAR ENDED SEPTEMBER 30, 2006**

**CASH FLOWS FROM OPERATING ACTIVITIES:**

|                                       |                    |
|---------------------------------------|--------------------|
| Receipts from customers               | \$ 973,067         |
| Payments to suppliers                 | <u>(1,023,376)</u> |
| Net cash used by operating activities | <u>(50,309)</u>    |

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:**

|  |                 |
|--|-----------------|
| Transfers to other funds                         | (240,000)       |
| Advances from other funds                        | <u>200,000</u>  |
| Net cash used by noncapital financing activities | <u>(40,000)</u> |

**CASH FLOWS FROM INVESTING ACTIVITIES:**

|  |                |
|--|----------------|
| Proceeds from sale and maturities of investment securities | 3,016,200      |
| Purchase of investment securities                          | (3,033,073)    |
| Interest and investment income (non program)               | <u>160,525</u> |
| Net cash provided by investing activities                  | <u>143,652</u> |

|   |        |
|---|--------|
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 53,343 |
|---|--------|

**CASH AND CASH EQUIVALENTS:**

|                   |                          |
|-------------------|--------------------------|
| Beginning of year | <u>409,011</u>           |
| End of year       | <u><u>\$ 462,354</u></u> |

**RECONCILIATION OF OPERATING INCOME TO NET  
CASH PROVIDED (USED) BY OPERATING ACTIVITIES:**

|  |                           |
|--|---------------------------|
| Operating income   | <u>\$ 112,575</u>         |
| Adjustments to reconcile operating income (loss) to net cash<br>provided (used) by operating activities: |                           |
| Depreciation expense   | 6,647                     |
| Changes in assets and liabilities:   |                           |
| Amounts due from primary government  | 87,324                    |
| Accounts receivable  | (26,079)                  |
| Accounts payable and other liabilities   | (28,121)                  |
| Compensated absences payable   | <u>(202,655)</u>          |
| Total adjustments  | <u>(162,884)</u>          |
| Net cash used by operating activities  | <u><u>\$ (50,309)</u></u> |

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Reporting Entity**

The Michigan State Hospital Finance Authority (the "Authority") was organized under Act 38 (the "Act") of the Michigan Public Acts of 1969, as amended to facilitate the ability of nonprofit, non-public health care corporations and facilities (the "facilities") to obtain financing and refinancing for capital improvements. The Authority consists of seven members including a chairperson and four public members, appointed by the Governor with the advice and consent of the Senate, and two ex-officio members (the State Treasurer and the Director of the Department of Community Health). The Authority functions independent of the State Treasurer who, as agent for the Authority, may not commingle funds and must maintain a separate bank account for the Authority. The Authority is a proprietary component unit of the State of Michigan (the "State") and is reported as such in the State of Michigan Comprehensive Annual Financial Report (SOMCAFR).

The Act empowers the Authority to issue bonds for the purpose of making related loans to facilities. The Authority issues bonds for facility equipment loans through the Health Care Equipment Loan Program (H.E.L.P.) and issues revenue bonds, including insured revenue bonds, and mortgage bonds for other capital needs of the facilities. Eligible facilities obtain funds from the Authority for specific capital projects by arranging for the Authority to offer bonds for sale. Each facility signs a note and enters into a loan agreement with the Authority for payment of the note. Such bonds are payable with monies received from each respective facility, as described below, and not from the general assets of the Authority. In general, loans made under H.E.L.P. are secured by the financed equipment.

All bonds are limited obligations of the Authority and are not obligations of the State. The State is not liable for payment of the bonds. The bonds are payable by the Authority, through designated trustees, solely from funds received from each participating facility in payment of the Authority's note and from investment earnings, undisbursed bond proceeds and other funds of each participating facility retained by the trustees on a bond issue-specific basis. Certain of the revenue and mortgage bonds are guaranteed by a bond insurance policy or a letter of credit if payments under the note and pledged assets are not sufficient to pay the bonds.

Participating facilities share the administrative costs of the Authority in an amount related to the principal balances of the respective outstanding bonds.

The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board Statements No. 14 and No. 39. These criteria include oversight responsibility, accountability for fiscal matters, scope of public services and special financing relationships.

In July 2002, an executive order was issued which combined the Authority's administrative staff with the administrative staff of several similar authorities into a single work unit under the direction and supervision of the State Treasurer.

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**B. Financial Statements**

The financial statements (i.e., statement of net assets, statement of activities, statement of revenues, expenses and changes in net assets and statement of cash flows) report information on all activities of the government. The Authority is considered a business type activity and has no component units.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include charges to customers who use, or directly benefit from services or privileges provided by a given function or segment.

**C. Measurement Focus, Basis of Accounting and Financial Statement Presentation**

The Authority is accounted for as a proprietary fund. A proprietary fund is used to account for operations:

- a) That are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or
- b) Where the governing body has decided periodic determination of revenues and expenses and net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

Proprietary funds are reported using the “economic resources measurement focus” and the “accrual basis of accounting”. Revenues are recognized when earned and expenses are recognized when the materials, services, or benefits are received. Service fees and other fees and charges are recorded as income when earned, and the associated administrative expenses are recorded as incurred.

Designated trustees maintain separate accounting records pertaining to each individual bond issue for each participating facility. Assets managed by the trustees for each facility are restricted for payment of bond principal and interest and approved construction expenditures except for certain investment income which may be returned to the facility. None of the assets or liabilities held by the trustees are reflected in the Authority’s financial statements, as more fully described in Note 7.

Bond proceeds are retained by the trustees to fund interest costs and principal payments during the period of construction. After the construction period, interest and principal payments are funded by regular loan payments from the facilities.

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**C. Measurement Focus, Basis of Accounting and Financial Statement Presentation (Concluded)**

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to the same limitation. The Authority has elected not to follow subsequent private-sector guidance.

Amounts reported as *program revenues* include charges to customers, services, or privileges provided. Likewise, general revenues include unrestricted investment income.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Authority are charges to customers for services. Operating expenses of the Authority include the cost of services, administrative expenses, and the depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

**D. Assets, Liabilities, and Net Assets**

**Cash and Cash Equivalents:** Cash and cash equivalents include deposits with financial institutions.

**Cash and Investments:** The Authority's deposits and investments are held in a fiduciary capacity by the State Treasurer. The Act restricts investments to obligations of the State or U.S. government, obligations of which the principal and interest are guaranteed by the State or U.S. government, certificates of deposit of a bank which is a member of the Federal Reserve System or a savings and loan association which is a member of the Federal Home Loan Bank System, certain classifications of commercial paper, U.S. government repurchase agreements, bankers' acceptances of U.S. banks, mutual funds composed of investment vehicles that are legal for direct investment by the Authority, and other obligations approved by the State Treasurer.

Investments are stated at fair value.

The Act requires all deposits of the Authority to be secured by obligations of the United States or of the State. The market value of these obligations must at all times be equal to or greater than the amount of the deposits of the Authority, and all banks and trust companies are authorized to give such security for such deposits.

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Concluded)**

**D. Assets, Liabilities, and Net Assets (Concluded)**

**Accounts receivable** - Accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a provision for bad debt expense when necessary and an adjustment to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Changes in the valuation allowance have not been material to the financial statements and no allowances are currently deemed necessary.

**Capital Assets:** Capital assets include office equipment. Capital assets are defined by the Authority as assets with an initial individual cost of more than \$1,000 and an estimated useful life in excess of one year.

Such assets are recorded at historical cost. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Capital assets are depreciated using the straight line method over the following estimated useful lives:

| <u>Asset</u>       | <u>Years</u> |
|--------------------|--------------|
| Office equipment   | 7            |
| Computer equipment | 5            |

**Compensated Absences:** Vacation, banked leave time and sick pay are recorded as expenses at the time the benefit is earned by the employee taking into consideration maximum contractual amounts. The Authority is allocated a percentage of assigned employees of the Bureau of Bond Finance. Each employee's total compensated absences is multiplied by the current allocation percentage.

**Amounts Due Trustees:** The Authority holds state and local government securities which by their nature could not be transferred to the trustees. When these investments mature, the funds will be remitted to the appropriate trustees. Therefore, these investments are recorded as current and noncurrent assets of the Authority, and a related liability is recorded to recognize the Authority's obligation to transfer the assets to the trustees. Interest earnings of these investments are paid by the Authority to the appropriate trustees.

**Estimates:** The process of preparing financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 2 - DEPOSITS AND INVESTMENTS**

As of September 30, 2006, the Authority had the following investments.

| <b>Investment Type</b> | <b>Fair value</b>   | <b>Standard<br/>&amp; Poor's<br/>Rating</b> | <b>%</b>      | <b>Investment maturities<br/>(in years)</b> |                     |
|------------------------|---------------------|---|---------------|---|---------------------|
|                        |                     |   |               | <b>Less than<br/>1</b>                      | <b>1 to 5</b>       |
| U.S. Agency Notes      | \$ 4,595,209        | AAA   | 98.6%         | \$ 2,386,345                                | \$ 2,208,864        |
| U.S. Agency SLGS       | 65,400              | AAA   | 1.4%          | 31,100                                      | 34,300              |
| Total fair value       | <u>\$ 4,660,609</u> |   | <u>100.0%</u> | <u>\$ 2,417,445</u>                         | <u>\$ 2,243,164</u> |

The above amounts are reported in the financial statements as follows:

Current:

Investments - operations \$ 2,386,345

Noncurrent:

Restricted - investments 65,400

Unrestricted - investments - operations 2,208,864

\$ 4,660,609

**Interest rate risk.** The Authority does not maintain a formal investment policy. However, the Authority minimizes interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by; structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities in the open market; and, investing operating funds primarily in shorter-term securities, mutual funds, or similar investment pools and limiting the average maturity in accordance with the Agency's cash requirements.

**Credit risk.** State law limits investments to government or government backed securities and deposits and commercial paper to within the two highest classifications established by two nationally recognized statistical rating organizations (NRSROs). The Authority has no formal investment policy that would further limit its investment choices.

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 2 - DEPOSITS AND INVESTMENTS (Concluded)**

**Concentration of credit risk.** The Authority, places no limit on the amount the Authority may invest in any one issuer however, the Authority does minimize concentration of credit risk, which is the risk of loss attributed to the magnitude of the Agency's investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized.

**Custodial credit risk - deposits.** At September 30, 2006, the carrying amount and the bank balance of the Authority's deposits was \$462,354. The September 30, 2006 balance was covered by federal depository insurance or collateral held with the Authority's agent in the Authority's name.

**Custodial credit risk - investments.** For an investment, this is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority will minimize custodial credit risk by; limiting investments to the types of securities allowed by law; and pre-qualifying the financial institutions, broker/dealers, intermediaries and advisors with which the Authority will do business.

**NOTE 3 - DUE FROM H.E.L.P. ISSUES**

The Authority has advanced funds for the purpose of paying the issuance costs related to the Health Care Equipment Loan Program (H.E.L.P.) bond issues. The proceeds from the H.E.L.P. bond issues are loaned to qualifying hospitals for hospital equipment. These advances will be repaid to the Authority during the H.E.L.P. loan repayment period. As of September 30, 2006, \$240,000 was advanced by the Authority.



**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 4 - CAPITAL ASSETS**

As of September 30, 2006 depreciable assets consisted of the following:

|                                 | Balance<br>September 30,<br>2005 |        | Additions  | Deletions | Balance<br>September 30,<br>2006 |
|---------------------------------|----------------------------------|--------|------------|-----------|----------------------------------|
| <b>Governmental activities:</b> |                                  |        |            |           |                                  |
| Capital assets:                 |                                  |        |            |           |                                  |
| Furniture and fixtures          | \$                               | 23,465 | \$         | \$        | \$ 23,465                        |
| Computer equipment              |                                  | 40,649 |            |           | 40,649                           |
| Depreciable capital assets      |                                  | 64,114 |            |           | 64,114                           |
| Accumulated depreciation:       |                                  |        |            |           |                                  |
| Furniture and fixtures          |                                  | 20,671 | 3,854      |           | 24,525                           |
| Computer equipment              |                                  | 32,708 | 2,793      |           | 35,501                           |
| Total accumulated depreciation  |                                  | 53,379 | 6,647      |           | 60,026                           |
| Net governmental capital assets | \$                               | 10,735 | \$ (6,647) | \$ -      | \$ 4,088                         |

All depreciation expense has been charged to the Authority's sole activity. Executive Order 2001-3 transferred the purchase and maintenance of the Authority's computer equipment to the Department of Information Technology (DIT). The Authority is charged back an allocation of the annual purchase and maintenance costs.

**NOTE 5 - COMPENSATED ABSENCES**

**Plan Descriptions**

Employees accumulate annual leave (vacation) balances to a maximum ranging from 240 to 316 hours. They receive a 100% termination payment upon separation based upon their final rate of pay. Employee sick leave balances accumulate without limit. Termination payments are made only upon separation from State service and only to employees hired prior to October 1, 1980. Payments at retirement or death are based on 50% of the employee's sick leave accumulation times their final rate of pay. When separating for any other reason, employees are paid a percentage of their unused sick leave which increases from 0% to 50% depending upon the balance of their sick leave hours. From October 2003 through October 2005, employees were required to participate in the Banked Leave Time (BLT) program. Under the BLT, each employees biweekly pay was reduced by up to 4 hours of pay. The unpaid time was credited to the employees BLT account and can be used for unpaid time off or it can accumulate up to 104 hours a year. Unused accumulated BLT is paid as an employer contribution to a 401(k) plan when the employee separates from service.

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 5 - COMPENSATED ABSENCES (Concluded)**

**Accounting Policy**

The Authority has accrued liabilities for compensated absences as required by the GASB. Annual leave is valued at 100% of the balance plus the State's share of social security and retirement contributions. Sick leave is valued, as explained, at 0% to 50% plus the State's share of social security and retirement contributions. Banked leave time is valued at the unused accumulated hours at year end. The pay rates in effect as of October 1, 2005 are used. As of September 30, 2006, the Authority has an annual leave compensated absences liability in the amount of \$64,942, a sick leave compensated absences liability in the amount of \$107,241 and a bank leave time compensated absence liability in the amount of \$7,111.

**NOTE 6 - EMPLOYEE BENEFITS**

The employer's share of life, health, optical, dental and long-term disability insurance premiums are charged by the State of Michigan to the Authority biweekly based on each employee's selected coverage.

**Defined Benefit Pension Plan**

The Authority's employees hired prior to April 1, 1997 are enrolled in a noncontributory defined benefit plan through the State Employees' Retirement System (the "Plan") upon meeting certain eligibility requirements. The Plan provides for retiree pension and other postretirement benefits such as, dental, vision, and major medical coverage. The cost of the pension is currently funded, while the costs of the other postretirement benefits are on a pay as you go basis. The costs of these benefits are allocated to the Authority as a percentage of payroll.

The Authority's covered payroll, which was also the total payroll, was approximately \$260,000, \$250,000 and \$345,000 for the years ended September 30, 2006, 2005 and 2004, respectively. The Authority's actuarially determined contribution requirements, and the contributions actually made, were approximately \$90,000, \$81,000 and \$94,000 representing 34%, 32% and 27% of annual covered payroll for the years ended September 30, 2006, 2005 and 2004, respectively.

The State Legislature establishes the extent to which the employer and the employees are required to make contributions and establishes the benefit provisions for the Plan. Additional detail and data regarding the Plan description, vesting, and eligibility requirements, actuarial cost methods and assumptions, funding requirements, accounting policies and ten year historical trend information is provided in the SOMCAFR and the Plan's detailed financial report issued by the Office of Retirement Systems. Those reports may be obtained by writing the Department of Management and Budget, Office of Retirement Systems, 7150 Harris Drive, P.O. Box 30171, Lansing, Michigan 48909 or by calling (517) 322-6262.

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 6 - EMPLOYEE BENEFITS (Concluded)**

**Defined Contribution Pension Plan**

The State Employees' Defined Contribution Retirement Plan (the Plan) was established to provide benefits at retirement to employees of the State who were hired after March 31, 1997 and to those members of the State Employees' Retirement (defined benefit) System, who elect to transfer to the plan. The Plan is administered by the State Treasurer. The State is required to contribute 4% of annual covered payroll. The State is also required to match employee contributions up to 3% of annual covered payroll. Plan provisions and contribution requirements are established and may be amended by the Legislature. The Authority transferred approximately \$7,800 to the State for its employer contribution. Employee contributions to the Plan were not significant.

**Deferred Compensation Plan**

Employees may also participate in a Section 457 plan and a 401(k) plan. Neither the Authority or the State makes an employer contribution to these plans. The assets and liabilities of the Section 457 and 401(k) plans are reported in the SOMCAFR and are not reported in the Authority's balance sheet.

**NOTE 7 - UNRECORDED LIMITED OBLIGATION DEBT**

The Authority has certain bonds outstanding. The trustee, fiscal agent, registrar, and paying agent functions for the defeased bonds are performed by an Authority designated trustee. Because these obligations are, in substance, debts of other entities, the liabilities and related assets are not reflected in the Authority's financial statements.

The Authority has defeased, in substance, certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Economic gains and accounting gains and losses upon in-substance defeasance inure to the benefit of the facility for which the bonds were issued and accordingly are not reflected in the Authority's financial statements.

The defeased, defeased and total outstanding bonds as of September 30, 2006 follows:

|                   |                                |
|-------------------|--------------------------------|
| Defeased          | \$ 1,294,065,000               |
| Defeased          | <u>4,855,970,911</u>           |
| Total outstanding | <u><u>\$ 6,150,035,911</u></u> |

**MICHIGAN STATE HOSPITAL FINANCE AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 8 - TRANSACTIONS WITH OTHER STATE AGENCIES**

The Authority is charged by various state agencies and departments for certain accounting, auditing, legal and cash management services. These fees were approximately \$364,000 for the year ended September 30, 2006. As of September 30, 2006, no amounts were due from or to other state agencies or departments for these services.

The Authority received reimbursements from other state agencies for expenses relating to salaries and administrative costs in the amount of \$44,168. As of September 30, 2006, \$4,486 was due to the Authority.

**NOTE 9 - RISK MANAGEMENT**

The Authority's risk management is provided through the State of Michigan. The State has elected not to purchase commercial insurance for many of the risks of losses to which it is exposed. The State is self-insured for most general liability and property losses, portion of its employee insurance benefit and employee bonding programs, automobile liability, and workers' compensation and unemployment compensation claims. The State has established two internal service funds, the Risk Management Fund and the State Sponsored Group Insurance Fund, to account for certain aspects of the risk management program. Additional detail and other data on the State's risk management program are provided in the SOMCAFR.



Lamonte T. Lator  
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Robert E. Miller, Jr.  
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James E. Nyquist  
James R. Dedyne

Timothy H. Adams  
David B. Caldwell  
Edward L. Williams, III  
Timothy J. Orians  
Dennis D. Theis

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Walter P. Maner, Jr. (1921-2004)  
Floyd L. Costerisan  
Leon A. Ellis (1933-1988)

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF  
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE  
WITH *GOVERNMENT AUDITING STANDARDS***

Michigan State Hospital Finance Authority  
Lansing, Michigan

October 17, 2006

We have audited the basic financial statements of the Michigan State Hospital Finance Authority, a proprietary component unit of the State of Michigan, as of and for the year ended September 30, 2006, and have issued our report thereon dated October 17, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Authority and management and is not intended to be and should not be used by anyone other than these specified parties.

*Maner, Costinison & Ellis, P.C.*

Certified Public Accountants